BMO Wealth Institute™

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Student tuition and debt on the rise: RESPs and beyond

The BMO Wealth Institute provides insights and strategies around wealth planning and financial decisions to better prepare you for a confident financial future.

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Student tuition and debt on the rise: RESPs and beyond

Should I contribute to my retirement plan, pay down my debt, save for my children's education, buy a nicer car or bigger TV, or take the family on a vacation? Whether or not you have the means, we are continuously pressured to focus our attention and disposable income on meeting these kinds of needs and wants.

Many families struggle to juggle education and retirement planning with ever-present consumption habits. By planning ahead and setting aside money for your children's education, you are also setting your children on a path to their future financial success.

By the time your child is in high school, the savings plan for your child's post-secondary education should already be in motion and nearly complete. If adequate education savings are not in place, your child may graduate with the added stress of carrying a student debt load before they have even landed their first job. According to the Canadian Federation of Students, Canadian post-secondary students graduate with an average student debt of $27,000. If most students take nearly 10 years to pay off their student loans[1], they are missing an opportunity: if the loan payment of $327.58[2] had been directed toward a continuous savings plan, rather than paying off a student loan, the accumulated savings could amount to a staggering $50,000![3] Without the worry of debt repayment after finishing school, then, your child could build up significant savings to fund many of life's milestone goals, such as buying a home, starting a family and, inevitably, saving for their own children's education.

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Cost of Post-Secondary Education

We all want the best for our children. In fact, 83% of Canadian parents expect that they will pay for their child's post-secondary education, with 44% expecting their child will also contribute[4]. And for many, that means the benefits a post-secondary education can deliver: a promising career and the enhanced earnings potential that comes from higher education. But the costs associated with pursuing post-secondary education have been on the rise. Tuition has been growing at a fast pace, and at

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times faster than inflation[5,6]. At the beginning of the 1990s, average undergraduate tuition fees in Canada were $1,464. Today, these fees have risen more than three-fold, to $5,581. While inflation was only 1.3% this past year, tuition fees increased 4.3%[7]. Currently, a four-year university degree can be expected to cost upwards of $60,000. That sum could rise to more than $140,000 for a child born this year[8].

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To compound the problem, many young people choose to return to school to earn a second degree, after facing a challenging job market. Returning to school only worsens the issues associated with funding post-secondary education cost and mounting student debt load.

Top Three Mistakes Parents Make Saving for Their Children's Education

With these staggering costs in mind, what are your options to help fund your child's education? Setting aside enough to cover the costs of post-secondary education without putting other priorities such as retirement or cash flow at risk requires careful planning. A good starting point is to "begin with the end in mind"[9]. From an education funding perspective, this means starting with a clear vision and understanding of projected costs for your child's tuition, residence, books, etc., adjusted for inflation. In other words, start with a financial plan that incorporates the projected costs of funding each of your children's post-secondary education. Only once you have a clear plan can you begin to take proactive steps to secure this vision effectively through a savings plan that maximizes all the strategies available to you.

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TOOLS

To Calculate education costs and savings needs use our Education Savings Calculator.

Unfortunately, a recent BMO Wealth Institute survey[10] suggests that the majority of parents do not "begin with the end in mind," since as many as three in four Canadian parents with children under 18 have not made a detailed estimate of the total cost of putting their children through post-secondary education. Here are some common mistakes to avoid when saving for education:

The majority of parents do not "begin with the end in mind," as three in four Canadian parents with children under 18 have not made a detailed estimate of the total cost of putting their child through post-secondary education.

1. Waiting too long to start saving for children's education and not saving consistently.

It's encouraging that as many as 70% of parents recommend saving right from the time of their child's birth, but only half have set up a registered education savings plan (RESP)[11]. Considering the rising school tuition and student debt, it pays to start early. The sooner you start to invest, the longer your money has time to grow, and often just the act of setting up an education savings plan can promote greater saving discipline. However, consistency is the key, and it is easiest to achieve by automating regular contributions throughout the year (e.g., pre-authorized bi-weekly or monthly payments from a chequing account). The benefit of making regular contributions to your child's education savings plan each year cannot be overstated, because of the power of compounding. The longer your money is invested, the harder it works for you. Give your contributions time to grow and produce results.

The graph compares Scenario 1, in which the parents contribute $2,500 per year for 12 years starting from the birth of their child, with Scenario 2, in which the parents start their child's RESP at age 12 and contribute $5,000 for six years. In both cases, the parents have invested $30,000, but the compounding of returns over time gives the RESP in Scenario 1 (starting from child's birth) a much higher balance.

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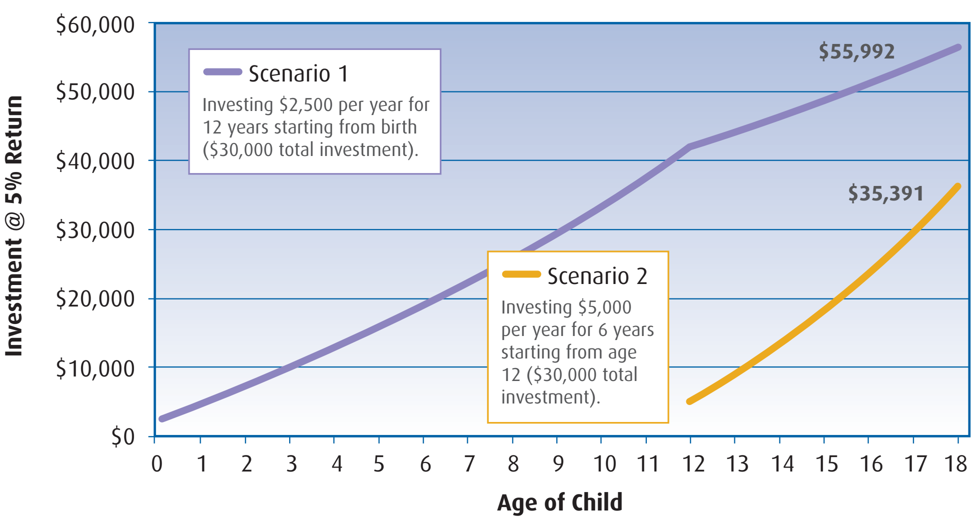
The Benefits of Investing Early



2. Not maximizing RESPs

An RESP is a smart way to maximize education savings and to role-model sound saving habits for your children. The tax-sheltered investment growth and eligibility for government grants can make a big difference to your child's future. Unfortunately, many parents miss the annual RESP contribution deadline (December 31) and leave free government money on the table. According to our survey, only half of Canadian parents are using an RESP to save for their child's education, and only 34% are taking full advantage of the available government grant[12]. Additionally, more than one-fifth (22%) of Canadian parents are not aware that the federal government offers a 20% Canada Education Savings Grant (CESG)[13]. The government matches 20% of the first $2,500 contributed annually, to a maximum of $500 a year, up to a lifetime maximum of $7,200 per child under age 18, with further grants available for lower-income families. In addition, there are also special grant programs available to residents of Alberta and Quebec. In the event that you cannot make an annual RESP contribution of $2,500 in order to receive the maximum annual CESG of $500, your unused grant contribution room may be carried forward. However, you will be limited in how quickly you can "catch up" on past unused grant contribution room (subject to a maximum $1,000 annual CESG payable to a beneficiary in any given year).

Only half of Canadian parents are using an RESP to save for their child's education, and only 34% are taking full advantage of the available government grant.

3. Not being aware of certain legal and tax rules (not knowing what you don't know)

In our survey, we found that almost one in three parents is either unfamiliar or not very familiar with the legal and tax implications of the accounts used to accumulate and eventually spend money for post-secondary education. Each saving vehicle has its own tax and legal consequences, which may or may not reflect your intentions. For this reason, it is important to consult a tax and legal professional to avoid surprises and to ensure that the saving vehicle you choose meets your objectives. It is not unusual for parents to be reluctant to transfer control

One in three parents is either unfamiliar or not very familiar with the legal and tax implications of education-saving options.

of investments if, as a result, their child has access to the funds. By retaining ownership, parents also keep control of their funds, but that may not be so advantageous from a tax savings perspective. On the other hand, a parent willing to forego control of funds could potentially realize tax savings on the investment returns. Before you begin saving for your child's education, know the legal and tax implications of the vehicles selected to accumulate the funds your child will need for post-secondary education.

THINGS TO CONSIDER

1. Who is the beneficial owner of the funds when the child:
   a) is a minor?
   b) reaches the age of majority?
2. How is the investment income earned taxed, and how are the withdrawals taxed, whether or not the child uses the funds for post-secondary education?
3. Who is entitled to the funds if the child does not pursue post-secondary education?

Five Options to Consider beyond RESPs

According to our survey, most parents are aware of RESPs (93%), but far fewer are aware of other options beyond RESPs to save for post-secondary education. If you are maximizing RESP contributions and are looking for other ways to help supplement the rising costs of post-secondary education, here are five strategies to consider.

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1. Non-registered account

One of the simplest ways to supplement your RESP savings is by opening a non-registered account specifically earmarked for saving for your child's post-secondary education. The key advantage of this type of account lies in its simplicity of set-up and the flexibility it provides. For example, you will not be subject to any special rules or restrictions concerning contribution amounts or their frequency, and you will maintain control over the timing and use of the funds, even when your child reaches the age of majority. In other words, you can withdraw funds for your own personal needs at any time or use them to fund your child's post-secondary education, or both. While the flexibility of not being restricted to using the funds to cover your child's post-secondary education may be an advantage for some, it might be a disadvantage for others who, without a strict focus on or commitment to educational goals, could be tempted to access the funds to cover their own personal expenses, jeopardizing the savings needed to cover their child's post-secondary education. Finally, although there are advantages associated with retaining beneficial ownership of such an account, the downside is that all the income (i.e., interest and dividends) and capital gains will be taxed in your hands, slowing the growth of the account.

Percentage of parents unaware of these education saving options

RESP	7%
Non-Registered Account	38%
TFSA	12%
'In-trust account'	45%
Trust	33%
Corporate Dividends	44%
Life Insurance	10%

Source: BMO Wealth Institute survey by Pollara, February 2013.

Some parents choose to open a non-registered account as an 'in-trust account' for their children. These parents are often drawn to an in-trust account because it appears to be simpler, easier to establish and much less expensive than a formal trust arrangement. It is not uncommon for parents to mistakenly open an in-trust account for a minor child under the misconception that they have established a trust. They often continue to operate the account as though the asset were their own, only to realize that they cannot maintain the control of the funds when their child attains the age of majority (18 or 19, depending on your province). To avoid such unintended results, it is important to formalize your trust (see option 3. Trust) and to set it up correctly by consulting a qualified legal and tax specialist.

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2. Tax-free savings account (TFSA)

If you have unused maximum TFSA contribution room, consider redirecting some of your savings from a taxable account (e.g., your personal non-registered account) into a TFSA. Your savings will grow tax-free, and you'll be able to withdraw the money in the future to help finance your child's education without incurring any taxes.

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Additionally, you can give your children funds to enable them to contribute to their own TFSA account, once they reach the age of majority (usually 18 or 19, depending on your province). However, be aware that your children will have full control over the use of their TFSAs. Alternatively, you can encourage your children to contribute towards their tuition fees by working part-time and contributing some of their earnings to their own TFSA accounts.

3. Trust

Using a trust to manage, control and protect funds that are meant to be used for the post-secondary education of the next generation may be an effective strategy. By using a trust, a parent (or grandparent) can have peace of mind knowing that the money in the trust will be used for the purpose for which it was intended.

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What exactly is a trust?

A trust is a legal relationship created when a person (the settlor) transfers possession and legal ownership of property to someone else (the trustee(s)) to hold the property for the benefit of someone else (the beneficiary or beneficiaries) according to certain terms. The assets transferred to trustees become their property, but they hold the assets in trust for the beneficiaries and deal with the property in the manner set out in the trust deed (the document that clearly lays out the terms of the trust, including how and when the funds can be used). While the settlor (i.e., the contributor of the funds) could also be the person who manages and controls the trust funds (the trustee), this should be avoided because of the income attribution rules contained in the Income Tax Act (ITA).

A trust should be documented with a written agreement that provides the terms and conditions for the use of the trust's income and capital (e.g., who gets an allocation of income, and at what age a beneficiary has access to capital).

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Two common ways to fund the trust, each one subject to different income tax consequences, are as follows:

1. **Gifting assets:** An irrevocable gift is made to the trust, and the contributor loses control over the use of funds for personal use.
2. **Loaning funds:** Funds are loaned to the trust, backed by a written loan agreement at CRA's prescribed rate in effect at the time you establish the loan (currently only 1%).

As a trust must meet certain requirements to be considered valid, and because the ITA contains several income attribution rules that restrict the ability to split income with family members, it is important to consult qualified tax and legal advisors for their professional guidance.

Consult qualified tax and legal advisors for their professional guidance on trusts.

4. Corporate dividends

If you are an incorporated professional or have an incorporated family business, consider accumulating funds in your corporate account, and later paying out company dividends to fund your child's education, starting the calendar year in which your child turns 18. This strategy would require having your child own shares of your company, either directly or indirectly. As the dividends will be taxed in the hands of your child, who will presumably be in a lower tax bracket than you, this may be a viable and tax-effective income-splitting strategy to explore with your professional tax advisor, particularly if you have excess cash in your company.

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5. Life insurance

Many people associate life insurance with preserving their wealth and planning their legacy. A lesser-known strategy is to use life insurance to fund a child's or grandchild's post-secondary education, by tapping into the excess cash value in the insurance policy.

Consider using life insurance to fund a child's or grandchild's post-secondary education, by tapping into the excess cash value in the insurance policy.

The mechanics work as follows: you would apply for a life insurance policy naming yourself, the parent (or grandparent), as the owner, and your child (or grandchild) as the life insured. The beneficiary (who would receive the death benefit) can be the owner or someone else. If you are the grandparent, for example, you can be the owner of the policy and name the parent of your insured grandchild as the policy beneficiary.

You would simply supplement your required monthly premium by paying additional sums that would build up the cash value within the life insurance policy. The growth would be tax-deferred inside the policy during the accumulation period. The more cash you deposit, the greater the amount of assets that can accumulate in a tax-sheltered environment (within set limits, which are a function of the age of the life insured and the duration and face amount of the policy). When your child or grandchild reaches the age of majority (usually 18, but it varies by province), you can transfer the ownership of the policy tax-free to your child. Once the policy is in your child's or grandchild's name as the new owner, your child or grandchild can draw down the excess cash values to pay for their post-secondary education costs or other expenses, and declare any resulting gains in their name at their personal marginal tax rate (presumably lower than your marginal tax rate). Keep in mind, however, that the main downside to this strategy is that you will lose control over the money put into the policy and the coverage offered by the contract.

Teaching Your Children about Money

Taking responsibility and setting aside funds for your child's post-secondary education is only half the battle. What your child knows and appreciates about money and how to save and invest will also be learnt from you. By the time they are ready for post-secondary education, they should be excellent money managers, capable of developing a budget and sticking to it, managing savings, and making commitments and sticking to them. Without a doubt, you'll have to put in a lot of thought, effort and encouragement over eighteen years. But an appreciation for saving and investing is one of the most valuable traits you can develop in your child.

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BMO SmartSteps® for Parents

Today's children are exposed to more gear, more gadgets and more high-pressure advertising than ever before. How can you prepare your kids to be prudent consumers and to manage money responsibly? BMO SmartSteps® for Parents can help. This user-friendly gateway to a wealth of expert advice, helpful articles, informative webisodes, expert blogs and fun games and activities can help give you and your kids a head start on the road toward making money make sense for the entire family. To learn more about teaching your kids about money, visit the BMO SmartSteps for Parents website:
www.bmo.com/smartstepsforparents/

TOOLS

To learn more about teaching your kids about money, click here

Conclusion

Post-secondary costs have been increasing steadily over the past decade. Parents who view themselves as bearing a large responsibility for funding their children's education can ease the burden by saving for their education as early as possible, ideally from birth, and by saving consistently on an annual basis. It's important to start with the end in mind – that is, by projecting the future costs of each of your children's post-secondary education. Thanks to the CESG government grant and tax-deferred compound growth potential, the RESP is an ideal education savings vehicle. If you have maximized your RESP contributions, there are several other education savings vehicles and strategies, such as the TFSA and trust accounts, to which you can direct further savings.

Speak to your financial professional for assistance with estimating the cost of your children's future post-secondary education and to get help creating a customized education savings plan that incorporates RESPs and any other strategies available to you.

1 Canada Student Loans Program, Annual Report, 2010-2011, HRSDC.
2 The loan payment estimate is based on an assumed student loan balance of $27,000 at the end of a student's studies. The calculations are using a fixed interest rate of 3% and a repayment period of 120 months.
3 The accumulated savings estimate is based on a monthly savings of $328 per month in a tax-free savings account for 10 years earning a 5% rate of return.
4,8 BMO Annual Parent Study: RESPs, Pollara, 2012.
5 Current projections estimate the cost of a four-year degree at a Canadian university to reach between $75,000 and $100,000 over the next 10 to 15 years. Education costs include tuition and a single residence room with meals and books. Projections are provided by CanLearn.
6 Current projections estimate post-secondary education tuition fees have been rising well above the rate of inflation and graduates are hitting the job market with an average student debt estimated to be almost $27,000. The Canadian Federation of Students, "Tuition Fees in Canada," Fall 2011.
7 The Canadian Federation of Students, "An Overview of Tuition Fees in Canada," Fall 2012.
9 Dr. Stephen R. Covey, Seven Habits of Most Effective People.
10,12,13 BMO Wealth Institute survey conducted by Pollara, February 2013.
11 BMO Financial Group survey conducted by Pollara, August 2012.